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SUBJECT: EADS OFFICIALS WARY OF TANKER DEAL REVIEW,
DISTRESSED OVER WEAK DOLLAR

REF: MUNICH 94

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SUMMARY

¶1. (SBU) In a meeting with ConGen Munich, senior EADS officials expressed concern about the potential outcome of Boeing's protest of the U.S. Air Force aerial refueling tanker award to the Northrop Grumman-EADS consortium, particularly given the political dimension the issue has taken-on in the U.S. The EADS officials dismissed Boeing's criticism of the award as "grasping at straws," and said the main reason Boeing lost was that it had a product gap between the 767 and 777 aircraft) a gap EADS, A330-based tanker was able to fill. The officials said EADS was applying lessons from Boeing's difficulties with the 787 program to its competing Airbus A350 program, which along with the A380 superjumbo and A400M programs, was proceeding according to schedule. EADS officials, greatest current concern is over the continued falling dollar, saying that the present exchange rate has put the company in the "death zone."

CONCERNED OVER BOEING PROTEST

¶2. (SBU) ConGen Munich met March 28 with EADS officials Wolfgang Wilhelm, Vice President for Aeronautics Strategic Business Development, and Goesta Klammt, Executive Assistant for Aerospace to EADS Chairman Ruediger Grube. Our contacts expressed concern, although not surprise, over the U.S. General Accountability Office (GAO) review of the contentious U.S. Air Force KC-45 aerial refueling tanker contract in the wake of Boeing's protest of the award of the contract to a Northrop Grumman-EADS consortium (Reftel). Wilhelm noted he would not expect a similar contract to go uncontested in Germany if awarded to a U.S. defense contractor.

¶3. (SBU) Wilhelm said he had just been in Alabama (where the EADS tanker is to be built) and had a very positive meeting with Governor Bob Riley, and hoped the Alabama political leadership would be able to serve as a counterweight to Boeing's vocal supporters in Congress who would like to see the tanker award retracted. Klammt expressed particular concern that there might be a blatant political attempt to overturn the Air Force decision by Congress, or the next

president, even if the GAO found the Air Force had consistently and appropriately applied USG contracting rules.

&BOEING GRASPING AT STRAWS8

¶4. (SBU) When asked about the concerns Boeing had raised over Northrop-EADS, successful tanker bid, Wilhelm said Boeing was essentially "grasping at straws," by raising issues such as the current WTO case involving Boeing and Airbus, EADS' untested alliance with Northrop, and alleged technical shortcomings of EADS' Airbus A330-derived tanker, including the unproven design of the refueling boom. Wilhelm said the reason Northrop-EADS won was that with the A330, it had a proven aircraft ready to go into production as a tanker. EADS also had a successful track-record with other U.S. defense contracts, most notably the Eurocopter LH-72 "Lakota" light helicopter award.

¶5. (SBU) Furthermore, Wilhelm added, EADS was not as inexperienced with tankers as Boeing had suggested, as it had been chosen to provide A330-based tankers to the Australian, British, Saudi and UAE Air Forces, and similar A310-based tankers to the Canadian and German Air Forces. Wilhelm was quick to dismiss the issue of the WTO case, noting that the U.S. and EU had signed the Agreement on Large Civil Aircraft in 1992, and the Air Force had itself determined that the WTO case would not be a factor in selecting the tanker. Concerning the critical and complicated refueling boom, Wilhelm noted that EADS had recently tested the boom under realistic conditions, and it had proven successful.

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¶6. (SBU) Wilhelm continued that Boeing lacked an airframe that provided the versatility of the A330, noting that the 767 Boeing had offered was smaller, lacking the fuel and cargo capacity the Air Force was looking for. Wilhelm said the 767 model Boeing had promoted in its bid "didn't actually exist," as it would be a composite of several different versions of the commercial 767 airframe. While Boeing had complained that it would have offered its 777 had it known the Air Force wanted a larger plane, Wilhelm pointed out that the 777 is significantly larger the A330, making it potentially too large for certain environments the Air Force operates in. Wilhelm said Boeing could have considered offering the 787 airframe, however that would not have been a realistic option considering the current backlog of orders for the plane.

"BOEING HAS A GREAT COMMUNICATIONS STRATEGY"

¶7. (SBU) Saying Boeing has "a great communications strategy" that has not been matched by its performance of late, Wilhelm noted that Boeing has experienced significant difficulties and delays with several projects, from the delivery of 767-based tankers to Italy and Japan, to well-publicized delays with the 787 Dreamliner program. Wilhelm said EADS/Airbus was learning from Boeing's difficulties resulting from its reliance on a worldwide network of "just-in-time" suppliers of major subassemblies for the 787) lessons EADS intends to apply to the production of its Airbus A350 competitor to the 787.

¶8. (SBU) Wilhelm said that despite these problems, Boeing had somehow been spared the level of negative publicity that EADS faced due to the delays of its A380 superjumbo, and A350 programs. Wilhelm said the A380 was proving a tremendous success, and that initial customer Singapore Airlines was very satisfied with the aircraft it had taken delivery of. EADS/Airbus is on track to deliver 13 A380s in 2008. Wilhelm said the A350 design had been "frozen," and the project would now proceed to the pre-production phase -- 2013 remains the

target for the first A350 delivery. Asked about the status of EADS' A400M military transport, Wilhelm said EADS expected the aircraft's initial flight this year, with the first delivery in 2010.

WEAK DOLLAR HAS PUT EADS IN THE "DEATH ZONE"

¶9. (SBU) Wilhelm reiterated his previous comment to us that EADS intends to also build A330-based freighter aircraft at the Mobile, Alabama plant being built for the final assembly of the Air Force tankers. He notably left open the possibility that additional EADS/Airbus aircraft may also be built in Alabama in the future. One reason for shifting production to the U.S would be to help offset the negative impact the weak dollar has had on EADS' bottom line. Echoing comments made earlier by Airbus CEO Tom Enders, Wilhelm said the weak dollar was having a devastating impact on EADS, and had put the company in the "death zone," as most of EADS, costs are in euros, but all commercial aircraft are priced in dollars.

¶10. (SBU) Every 10 cent decline in the dollar costs EADS one billion euros. Furthermore, EADS' restructuring plan implemented last year was based on an exchange rate of USD 1.35 to the euro. EADS had attempted to mitigate the falling dollar with currency hedging contracts, but they will run-out this year, leaving the company in a very vulnerable position. Klammt said he wondered if a continued weak dollar might ultimately lead to the euro supplanting the dollar as the currency of choice for pricing aircraft and commodities such as petroleum.

"EADS WANTS TO BUILD THE NEXT AIR FORCE ONE"

¶11. (SBU) Despite concerns about Boeing's protest of the tanker award, Wilhelm was optimistic that EADS would continue to make further inroads into the U.S. defense market,

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acknowledging that European governments would not prove to be a reliable source of increased defense spending in the future. Wilhelm suggested, perhaps only half-jokingly, that in the wake of the tanker deal and the selection of a European design from AgustaWestland for the next Marine One presidential helicopter, EADS would work to win the contract for the next Air Force One, offering its A380 superjumbo as a replacement for the current Boeing 747s.

COMMENT

¶12. (SBU) Wilhelm's remarks, even if tongue-in-cheek, about building the next Air Force One demonstrate a self-confidence on the part of EADS we haven't seen during the past several years, given the stream of bad news from the A380 and A350 programs. Still, it was evident EADS was not counting on walking away with the tanker award just yet, given the political maneuvering in the U.S. If there is one thing that worries EADS executives more than losing the tanker deal (which Wilhelm acknowledged they didn't really expect to win in the first place), it's the falling dollar. While "death zone" may be a little dramatic, EADS will indeed face a financial crisis following the expiration of currency hedges this year if the dollar remains at its current level against the euro. Given this stark reality, and no indication that commercial aircraft will be priced in euros in the near future, EADS, only viable solution will be to shift some production to lower-cost dollar-zone locations such as Alabama.

¶13. (U) This report has been coordinated with Embassy Berlin.

¶14. (U) Previous reporting from Munich is available on our SIPRNET website at www.state.sgov.gov/p/eur/munich/ .
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